BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The case involves an important question in the administration of the Securities Act of 1933 which it is in the public interest to have decided. No case heretofore has arisen in which a Federal Court has been called upon to determine whether it shall grant or deny specific performance of an agreement touching the marketing of securities where such agreement was, in violation of the provisions of the Securities Act of 1933, falsely represented in the registration statement filed with the Securities and Exchange Commission. The Circuit Court reversed the decision of the District Court in which it had been held that the agreement should not be enforced because it was an essential part of an illegal scheme and the parties should be left where they found themselves.

The Circuit Court's opinion will have the effect of frustrating the purposes of the act in three important particulars:

(1) If persons identified with the marketing of securities are assured that the Courts will hold valid and enforceable contracts the purpose of which is to deceive the investing public, such agreements will multiply. The decision declares that the Courts will regard as enforceable, and to that extent valid, an agreement entered into for the purpose of concealing respective interests of the offerors of stock and for the purpose of inducing investors to buy more stock than they would if the agreement were revealed in the manner contemplated and required by the Securities Act. The decision thus gives validity to that which the Securities Act is designed to prevent. To that extent the decision encourages rather than discourages falsity in registration statements, thereby thwarting the

primary purpose of the Securities Act—truthful disclosure as to each new security issue, to the end that no essentially important element attending an issue shall be concealed from prospective investors or misrepresented to them. The decision is, therefore, contrary to the generally accepted principle enunciated in such cases as *Sage* v. *Hampe,* 235 U. S. 99, 105; *McMullen* v. *Hoffman,* 174 U. S. 639, 669-70; *Primeau* v. *Granfield,* 193 Fed. 911, cert. den. 225 U. S. 708; *Barnsdall* v. *Owen,* 200 Fed. 219.

(2) The decision is erroneous in its determination that the false representations in the registration statement were immaterial. The Circuit Court in its opinion minimizes the importance of the falsehoods here involved and in effect holds them to be harmless or not material. The opinion does not use the word "material" but the Court says:

> "We do not see that any misstatements were made to the Commission in respect to matters which might mislead investors to their damage"; "nor can we see that the errors in the statement could mislead prospective purchasers"; that "the public offense committed by Judson * * * was one of little practical significance"; and that the "violation of the Securities Act * * * never caused investors in the stock any harm * * *."

By such language the Court thereby fixes standards of harmfulness and of materiality which will render the Commission impotent in many cases in its attempts to enforce the Act. The "materiality" of a representation in a registration statement is an issue of great importance in prosecutions under Section 24 of the Securities Act (15 U. S. C., Sec. 77x) providing criminal penalties for any person who "makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading." Material misstatements or omissions in registration statements or

prospectuses may give rise to civil liabilities to purchasers (§§ 11 and 12(2), 15 U. S. C., §§ 77k and 77l(2)), stop order proceedings by the Commission (§ 8(d), 15 U. S. C., § 77h-(d)), and suits by the Commission for injunctive relief (§ 20(b), 15 U. S. C., § 77t(b)). A ruling, therefore, that the representations in this case which were found by the Master and the District Judge to have been deliberately and purposefully made (R. 2544) and for the purpose of deceiving investors (R. 2542), are immaterial—and that is the effect of the decision—has wide implications which make it in the public interest that the decision be reviewed by this Court.

Whether the agreement is to be enforced should be determined not on the narrow basis of whether investors were in fact harmed by the failure to disclose, but rather whether there is a public policy against such enforcement. The public policy against enforcement may be found either (1) by looking to the purpose of the conduct and its possible effect upon investors or (2) by looking to the public policy against such enforcement which is to be found in legislation of recent years.

(3) The Court found specifically that the secret agreement as to the 18,000 shares, the splitting of underwriting profits, and the false representations were all part of a scheme to deceive the Securities and Exchange Commission and the public (R. 2542). Other findings strengthening this conclusion are set forth herein (*infra*, pp. 7, 8). These findings are not controverted by the Circuit Court, however submerged they may be in its discussion. By any interpretation of Civil Rule 52, such findings cannot be discounted, particularly where, as here, the evidence was conflicting and one of the elements involved in the District Court's determination was the relative credibility of the two principal witnesses. (See *Malloy* v. *New York Life Insurance Co.*, 103 F. (2d) 439.)

In addition to the purpose to deceive, there was here also the likelihood that the public would be deceived. The test here should be objective rather than subjective. Would the average investor reasonably be led to a different conclusion regarding his decision to purchase or not to purchase? The information that petitioner, an underwriter and large stockholder was or was not selling his stock is information which should be disclosed to a prospective investor, and would undoubtedly influence an investor in determining whether or not to buy the stock offered to the public. If two "experienced manipulators" such as the Court found respondent and petitioner to be, thought it important that their arrangement be concealed in order to deceive the Securities and Exchange Commission and the public, who is to say in applying an objective test that their fears as to the risk involved in disclosure were ill-founded? In addition, it is extremely unlikely that the Management group, who under the marketing arrangements were supplying 72,000 shares of stock, would have gone along with the marketing program had they known of the secret profits which respondent was to receive.

This Court should determine whether under these circumstances the decision of the District Court was erroneous when it stated:

> "This secret agreement or arrangement as to the 18,000 shares of Bath Iron Works stock, the splitting of underwriting profits, and the false representations are all part of the scheme to deceive the Securities Exchange Commission and the public. I agree with the Special Master that the part of it which the plaintiff now seeks to enforce is illegal and unenforceable. In my opinion it would be encouraging deceit and contrary to public policy for this court to lend its aid in carrying out a conspiracy of this character."

The Circuit Court while recognizing that petitioner and respondent were co-adventurers, nevertheless stressed the

principal and agent relationship existing between the parties (R. 2594). On this the District Court said (R. 2543):

> "The contention of plaintiff that the parties are not in *pari delicto,* assuming that plaintiff was less guilty than defendant is inapplicable, for the Master has found that both Judson and Buckley 'were experienced manipulators' and that the contracts between Judson and Buckley were made for the purpose of concealing the fact that Buckley had an interest in the sale of the stock, and as an aid to the falsification of the Registration Statement, and were entered into by Judson and Buckley to circumvent the Rules and Regulations of the Securities and Exchange Commission. The method and the reasons were discussed by Buckley and Judson. What was done by Judson was done deliberately and purposefully. If there be any conflict between the application of the rule for the protection of a fiduciary relationship and the rule holding illegal contracts unenforceable, the latter rule should prevail under the circumstances here presented."

For the Circuit Court to emphasize the fiduciary relationship as a reason for granting specific performance in this case is to create an anomalous situation in the law in which the closer the relationship of conspirators, the more disposed are the courts to enforce arrangements between them.

The only reported case dealing with the enforcement of contracts involving a violation of the Securities Act of 1933 is that of *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corporation,* 312 U. S. 38. That case involved a suit by an underwriter against the issuer for breach of contract. The plaintiff, through its agent, had been given an option by the defendant issuer on 1,300,000 shares of its treasury stock at 10 cents a share. The option agreement was later modified to authorize the issuer to sell the shares directly and credit plaintiff with the proceeds over and above 10 cents a share. Plaintiff sued for (1) damages for the refusal to deliver all the stock under the option agreement and (2)

the excess above 10 cents a share received by the issuer on certain sales to other persons. The issuer's defense was that the shares had never been registered under the Securities Act of 1933, in violation of Section 5 of that Act (15 U. S. C. § 77e). This Court gave judgment on both causes of action holding that the essential purpose of the act would, on the facts in that case, actually be hindered by non-enforcement.

In the present case there is, however, no need to balance against the benefit which would accrue to investors from the point of view of discouraging future illegal agreements any harm which they might suffer from refusing to enforce the illegal agreement before the Court, because they would suffer no harm as a result of non-enforcement. Since there is no investor interest, immediate or otherwise, to be served by enforcing the agreement, the conclusion seems to be compelled that the ultimate protection of investors and the public generally would be better served by refusing to buttress the unlawful conspiracy with the legal process of the courts.

The case at bar is not a mere claim of illegality for non-compliance with the law, or with the rules and regulations of a governmental body, but one in which the Court found active fraud and purposeful deceit in the making of false representations and in concealing facts from a governmental body, in which deceit the alleged agreement played an essential role and by which respondent hopes to profit.

No such facts exist in the *Frost* case. There was neither false representations nor concealment. There were no dealings with the governmental body and no Registration Statement. The *Frost* case was an action at law, and not in equity. Frost & Co. sought damages for breach of contract for the sale of stock and defendant set up illegality because the stock had not been registered under the Securities Act. This Court found there was no evidence of criminality (p. 42); that the contract was fair on its face (p. 42); and the

public was better protected by enforcement than non-enforcement (p. 43).

There is no comparison between the culpability of one who fails to file a Registration Statement because he believes, although perhaps mistakenly, that the offering is not a public offering, and that registration is not necessary, and those who deliberately conceal facts and sign and file false statements for the purpose of deceiving the public and the Securities and Exchange Commission, as the Master and the Court found was done by the Registration Statement and the secret oral agreement in this case.

In addition to the above considerations Congress has established a legislative policy against enforcement of such contracts. In the Circuit Court of Appeals, counsel for respondent in arguing that the arrangement in the present case was not contrary to public policy and therefore not void, stressed the fact that to deny relief in this case would be to add to the sanctions in the form of criminal penalties and civil liabilities which were provided by Congress when it enacted the Securities Act of 1933. But the Act itself contemplates additional sanctions to those prescribed in the statute.

The Securities Act of 1933 specifically provides in Sec. 77p, Title 15, that the "rights and remedies provided by this sub-chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity". In other words, by the very terms of the Act it is contemplated that other sanctions shall still be available.

In determining whether there is a public policy which renders such contracts unenforceable it is important to look into the Federal legislation of recent years dealing with securities.

In the Securities and Exchange Act of 1934, 15 U. S. C. Sec. 78cc it is provided that:

> "(b) Every contract made in violation of any provision of this chapter or of any rule or regulation there-

> under, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, * * *"

Virtually identical provisions are found in the Public Utility Holding Company Act of 1935, 15 U. S. C. Sec. 79z; the Investment Companies Act of 1940, 15 U. S. C. Sec. 80a-46; and the Investment Advisers' Act of 1940, 15 U. S. C. Sec. 80b-15.

It should be remembered that the Securities Act of 1933 was the first in this series of acts having to do with investments. Each of the subsequent Acts contains the provision indicating quite clearly a Congressional policy that the Courts shall not enforce agreements made in violation of the Acts. If the early Acts had contained the provision and the subsequent acts had omitted it it might then well be argued that the Congress did not intend that such contracts should be regarded as void and unenforceable in suits for specific performance. Here, however, we have expressions from the Congress since the enactment of the Securities Act of 1933 from which can be spelled a consistent and uniform policy that such contracts shall not be enforceable. The same basic principle underlying the Securities Act likewise underlies the Acts which followed it.

The public policy underlying each is the same. One purpose of the Securities Act of 1933 as outlined in the Report of the Committee on Banking and Currency was to prevent exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor.

One purpose sought in the passage of the Securities Exchange Act of 1934 was to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business conditions of the company, the securities of which he may desire to buy or sell. The 1934 Act supplements the 1933 Act and in turn the enactments of 1935-1940 supplement the first two, and behind each there is a common purpose. The pattern of each is likewise much the same. For example, in each of the Acts there is provision for registration statements and reports to the Commission. The registration requirements provided for in the Securities Act, 15 U. S. C. Secs. 77f, 77g are of the same pattern as the registration requirements in the Securities and Exchange Act, 15 U. S. C. Secs. 78*l*, 78m, 78o, and 78o-3; the Public Utility Holding Company Act, 15 U. S. C. Sec. 79e; the Investment Companies Act, 15 U. S. C. Secs. 80a-8, 80a-24; and the Investment Advisers' Act, 15 U. S. C. Secs. 80b-3, 4. To hold that there is a public policy against enforcement of contracts the performance of which involves a violation of the registration provisions of the Acts of 1934, 1935, and 1940, but that there is no such policy as far as the violations of almost identical registration provisions of the Securities Act of 1933 is unrealistic. The public policy behind non-enforcement which is specifically recognized in recent legislation should be recognized by the Court.

The question is not whether the Securities Act specifically declares such contracts unenforceable. The question is whether there can be found in the legislation of recent years a public policy which holds such contracts void. Upon examination we find just that. Whether a contract shall be enforced requires consideration of the broad purpose of the Securities Act and, of the broad purposes of relevant statutes.

In a Governmental structure in which administrative agencies require, in the public interest, numerous disclosures of personal and business dealings, it is important to have it declared whether the Courts of the United States will enforce any arrangement which is an essential part of a scheme to defeat the Governmental requirements of disclosure. The importance of clarity on the subject of enforceability of such arrangements applies not only in the case of transactions which come within the purview of the regulations of the Securities and Exchange Commission, but to all types of secret, undisclosed transactions which under the laws of the land are made the subject of scrutiny by the other numerous agencies of the Government. By the decision in the present case, doubt is thrown as to the present applicability of the heretofore well-recognized principle that a contract, the object of which is the deception of the public and of public officials in the performance of their duties, is contrary to public policy, void and unenforceable. The Circuit Court does not purport to repudiate this doctrine in general terms, but in denying its applicability to the facts in the present case it does for all intents and purposes reject the doctrine in a situation where it has been generally conceded that it should apply.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

GORDON DEAN,
BRIEN MCMAHON,
WALTER GALLAGHER,
THOMAS F. CHAWKE,
NATHANIEL W. GOLD,
Counsel for Petitioner.

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